Pre-Approval of Utility Generation Investments:
Comments of Thomas M. Power
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Support for SB 195

As a professional economist I have been involved in electric utility supply planning since the mid-1970s when I was hired by the Montana Public Service Commission to analyze the need for the proposed Colstrip 3 and 4 facilities. Since then I have testified on behalf of utility regulators and consumer groups around the nation in over 100 regulatory proceedings. In Montana I have served on various governors' energy advisory committees and since 1987 have served on the Montana Power Company and then the NorthWestern Energy Company technical advisory committees.

As an economist, I am concerned that the regulatory rules governing investor-owned utilities continue to provide the appropriate incentives so that those private utilities provide safe and reliable service at minimum long term social costs.

Careless changes in those regulatory rules can lead to the shifting of the consequences of the unavoidable risks associated with electric utility supply from the private investors to customers. Such risk shifting reduces the incentives for the private utility to manage that risk and reduce the costs associated with it. The likely result will be unnecessarily costly facilities and excess supply, both of which will burden customers and our economy.

This is not speculation. Electric suppliers have gone through two costly cycles of "irrational exuberance" for expanding generation in the last 30 years, followed by an inevitable "irrational reluctance" to build generation. We happen to be in one of those periods of "irrational reluctance" to build generation in which electric suppliers want the public, directly or indirectly, to subsidize their private businesses by shifting risks and costs from the private business to citizens or customers. Those private utilities, do not, of course, wish to accept a lower return on their investments as a result of that public support for their private businesses.

Just a decade ago, electric suppliers were begging to be freed from regulation so that they could flood the market with incredibly inexpensive new electric supply. Foolishly we gave them what they asked for. The result, for a while, was a flood of proposals both in Montana and across the nation to build new, unregulated, merchant generating facilities that would sell into unregulated markets. Some of those unregulated generating facilities got built. Many of them were abandoned when volatile electric and natural gas markets rendered them highly risky. In the aftermath, the "hangover" if you want, of that irrational and costly over investment, we are now told that no one will invest in new generation unless the public takes on most of the risk and some of the costs.

The same was said after the previous period of over-investment and loss during the late 1970s and early 1980s when across our region and nation electric utilities went on a nuclear and coal-fired building spree that led to massively costly and unnecessary generating facilities, many of which had to be abandoned at the cost of hundreds of millions of dollars each. The excess capacity and lack of market for the output of Colstrip 4 in Montana almost drove the Montana Power Company into bankruptcy.

After that, we were also told that private investors would never be willing to again take on the risk of building new electric supply. The lights, however, did not go out. A decade later electric suppliers were clamoring to be allowed to invest in electric supply and sell into unregulated markets. That led us to where we are today.

Before tinkering with the incentives we have in place to encourage utilities to carefully seek to balance supply and demand and control costs, consider what would have happened if "pre-approval" had been in place during the last electric supply building boom? How many unnecessary and extremely costly gas-fired generators would have been built and assigned to customers to pay for?

If we want public regulation of privately-owned utilities to continue to be a viable, low-cost way of providing electric service to customers, certain incentives structures absolutely must remain in place. First, the private utilities have to be responsible for controlling the costs and timing of the construction of generating facilities and their ability to actually perform as designed. Cost-plus blank checks are entirely inappropriate. Customers cannot control the costs and timing of construction nor can they assure that complex technologies will actually work. The responsibility and consequences of those decisions have to rest with investors as they do in every other sector of our economy.

Other aspects of electric supply do have a public-policy aspects to them: environmental costs and risks, protection of customers from market price volatility, appropriate levels of reliability, assuring access to a modern necessity to those of limited means, etc. Here our private utilities and their regulators do need to reach agreement as to what is in the public interest.

We must not allow these shared public interests, however, to completely blur the necessary line between the responsibilities of private investors and those of their regulators when it comes to important aspects of electric supply decisions. If we do so, we are highly likely to face unnecessarily costly electricity supply in the future.